

FREEDOM OF ESTABLISHMENT AFTER CARTESIO: ABSENCE OF EC INCORPORATION DOCTRINE AND IMPLICATIONS THEREOF

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*This article defines private international law doctrines of incorporation and real seat and then turns to the analysis of freedom of establishment guaranteed by the EC Treaty. The article analyses judgments of the European Court of Justice, interpreting the freedom of establishment in cases where companies tried to transfer their seats across frontiers, especially in light of the newest judgment in this area in the *Cartesio* case. The analysis of case law shows the link between the freedom of establishment and private international law doctrines. The article is concluded by a discussion of opportunities that freedom of establishment provides for companies, alternatives for cross-border business restructurings and implications of rising number of these activities.*

*Straipsnyje apibūdinamos tarptautinės privatinės teisės taikomos inkorporavimo ir buveinės doktrinos ir tada analizuojama EB steigimo sutarties garantuojama steigimosi laisvė. Aptariama Europos Teisingumo Teismo praktika interpretuojant steigimosi laisvę bylose, kai bendrovės bandė perkelti buveinę už valstybės ribų. Atsižvelgiant į tai, kaip supratimą keičia naujausia byla šioje srityje – *Cartesio*. Teismo praktikos analizė parodo steigimosi laisvės ir tarptautinės privatinės teisės doktrinų ryšį. Straipsnis baigiamas aptariant galimybes, kurias bendrovėms suteikia steigimosi laisvė, ir alternatyvas, kuriomis jos gali pasinaudoti, siekdamos pertvarkyti verslą, kai tai apima kelias valstybes, bei šio reiškinio dažnėjimo padarinius.*

Introduction

This article analyses the freedom of establishment as guaranteed by the EC Treaty and what rights it confers to companies to restructure businesses across-border by transferring central administration to another Member State. Further we discuss what the link between conflict of laws rules applicable by the private international law of Member States with the freedom of establishment is. This analysis is provided in

the light of *Cartesio*¹ judgment of the European Court of Justice (ECJ) as decided at the end of 2008.

The article begins with the general description of the different doctrines of conflict of laws rules applicable to companies. Then it continues with the analysis of the freedom of establishment in the company mobility cases as decided by ECJ and tries to find the link between the two. The

¹ Case C-210/06 *Cartesio Oktató és Szolgáltató bt.*

concluding part will try to shortly assess what impact does this interlink have on the cross-border restructurings of the companies.

The article is comprised of analytical analysis of the ECJ case law on freedom of establishment and related topics and comparison of conflict of laws rules applicable by the different Member States. The object of analysis of the article is the freedom of establishment as guaranteed by the EC Treaty. The article aims to answer to what extent the freedom of establishment guarantees the right for companies to restructure businesses across frontiers, without undergoing formal re-registration procedures in the host Member State.

The issue of development of freedom of establishment in the case law of ECJ has been widely discussed in academic literature, however this article analyses the newest case of *Cartesio* and how it explains the freedom of establishment and position of ECJ in previous cases. As the popular position in the academic literature prior to *Cartesio* was that the early case law on freedom of establishment is no longer actual and there should be EU wide incorporation doctrine, the newest case law seems to alter the picture. In Lithuania the topic has not been discussed in academic literature after the *Cartesio* and therefore the issue is novel. Furthermore the article seeks to raise awareness in Lithuania of the possibility and effect of application of EC Treaty principles in the context of company law (and show that EC company law is not limited by company law directives and regulations).

1. Incorporation doctrine in private international law

Conflict of laws rules in private international law provide for two solutions how status and legal capacity of a legal person is established: incorporation doctrine and real seat doctrine [10, p. 175–176].

Conflict of laws rules in countries of incorporation doctrine provide that status and legal capacity of a legal person is established by the laws of the country in which this legal person has its registered office (statutory seat). Accordingly, under this doctrine where the legal person transfers its principal activities (with central administration) from country A to country B, both following incorporation doctrine, the country B will look at the laws of country A to see whether the legal person has retained its capacity, and the answer will be affirmative. The incorporation regime is seen as flexible, allowing transferring of businesses inside and outside the country on a going concern basis (without the need to wind-up in one state and re-register in another) and providing legal certainty as the question of loss of legal capacity does not arise with the company expanding activities across frontiers.

Conflict of laws rules in countries of real seat doctrine provide that status and legal capacity of a legal person is established by the laws of the country in which this legal person has its central administration (real seat – where the management of the company resides and steers the company). Accordingly, where a legal person transfers its principal activities (with central administration) from country A to country B at least one of which follows

real seat doctrine, and does not re-incorporate in the country B, it will lose its legal capacity as the country, following the real seat theory, will check and see that it is not incorporated within the country of its central administration. The real seat doctrine is seen as a better tool for retaining higher standards of protection of creditors, minority shareholders and employees, helping to avoid abuse as it does not allow choosing another country with the lowest standards of regulation and then moving back to render business in the former country.

There may be other variations as well, say for instance a situation where a company is incorporated in country A, has its central administration in country B (where both A and B are incorporation doctrine states) and this company has also business in country C. If country C follows the real seat doctrine, will it find the company to have no legal capacity, as it is not incorporated in B? Would the answer be different if country B followed real seat doctrine? The real seat doctrine has different modifications and this paragraph serves to show that the issue is more complicated than may seem to be from the first sight. However the detailed analysis of real seat doctrine variations is out of scope of this work.

Incorporation doctrine is currently applied in such Member States as the United Kingdom and the Netherlands, while real seat doctrine is applied in Germany and Italy. Lithuania according to private international law rules [1, Part I Art. 1.19] applies incorporation doctrine.

These two (incorporation and real seat) are doctrines of private international law. On the European Union level we do not

have a harmonizing document telling what approach should Member States adopt in relation to companies incorporated in other Member States [9, p. 490]. The recently in force Rome I regulation, defining law applicable to contractual obligations, explicitly excludes issues of legal capacity and incorporation of legal persons from its scope [8, Part I Art. 1(2)(f)]. This is a drawback in particular when we refer to the fact that company law is highly harmonised area² and there should be a mutual trust that the standards of regulation of companies are high throughout the Union. The question is even more complex when we remember that the EC Treaty guarantees freedom of establishment of the EU nationals – natural persons and companies. What is a link between the freedom of choosing an organisational form of business, freedom to transfer it across borders (inside EU) with the conflict of laws rules recognising or not recognising status and legal capacity of a company? We will try to analyse this link below.

2. ECJ case law on freedom of establishment

The freedom of establishment is guaranteed by the Articles 43 and 48 of the EC Treaty. This amounts to primary and secondary establishment – freedom to form a principal place of business in another Member State and secondary establishment – set-up agencies, branches or subsidiaries. Freedom of establishment guarantees companies op-

² With certain exceptions only, such as areas of corporate governance – lasting debate about one tier and two tier boards; also partly company groups regulation.

portunity to allocate tangible and intangible resources throughout different Member States, choose organisational structure and specific legal regime for this organisation structure [11, p. 129–131; 8, p. 495]. However not all the companies may enjoy the freedom of establishment. Under the Article 48 of the EC Treaty the freedom is granted only to companies: 1) duly established in a Member State; and 2) having a link (or connecting factor) with a Member State: a) registered office, b) central administration; or c) principal place of business in a Member State. These two criteria are in certain cases a decisive factor to determine whether the company may enjoy the freedom of establishment.

Analysis of the case law on freedom of establishment and in particular mobility of companies across frontiers may be categorised into emigration and immigration cases. This depends on whether the Member State seeking to regulate mobility of a company is the origin country for that company, in which case this is an emigration case; and *vice versa* where the Member State is the host country for that company, it may be referred to as an immigration case. Here we refer to the transfer of the real seat (central administration) of the company in question but not the registered office – *i. e.* situations where the company stays registered with the Member State of origin (with the laws of the Member State of origin, such as shareholder rights, corporate governance, raising and maintaining of capital continuing to apply³) [12, p. 667] but transfers its

³ However again there is uncertainty as to the extent of origin Member State laws applicable – even incorporation doctrine host Member States will apply their

real seat (central administration) to another Member State and, in most situations, not renders any material activity in the Member State of origin.

ECJ started with a restrictive approach in an early case on mobility of companies – the *Daily Mail*⁴. This was an emigration case. The company *Daily Mail* wanted to emigrate (move central administration) with its tax residence from the United Kingdom to the Netherlands for tax reasons, but for this UK Treasury's consent was needed. The Treasury requested before the transfer of central management to sell certain assets (most probably so that capital gains accumulated are realised and taxed in the United Kingdom). *Daily Mail* then alleged that the freedom of establishment as guaranteed by the EC Treaty should allow it to emigrate without asking for the UK Treasury's consent. ECJ restated that the freedom of establishment is directly applicable. The Court indicated that UK allows secondary establishment, *i. e.* right for the company registered and operating in the United Kingdom to establish agency, branch or subsidiary in the other Member State. However the situation in the case was different as *Daily Mail* tried to transfer its central administration to the Netherlands while staying registered in UK. The Court stated that companies

rules in certain situations, such as taxation on income originating in the host country, liability of shareholders or managers in the event of fraudulent insolvency or opening of insolvency proceedings (this area being harmonised in the EU – see Art. 3.1 of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings).

⁴ Case 81/87 *the Queen v H. M. Treasury, ex parte Daily Mail*, [1988] ECR 188, p. 5483.

are created by national law of the Member States determining their incorporation and activities. The Court went further to state that problems arising in the event of transfer of registered office and/ or central administration have to be dealt by the Community wide legislation in the future. The Court concluded that the freedom of establishment notion does not guarantee a right of a company to transfer its central administration to another Member State while staying registered with the former Member State [13, para. 17–25]. Obvious outcome of *Daily Mail* was at least (interpreted narrowly) that the Member State of origin of the company was allowed to control and refuse the emigration of such company and, if interpreted widely, that the freedom of establishment guaranteed only the right to secondary establishment.

A company mobility situation was further decided in the probably most widely debated company law case of the ECJ ever – *Centros*⁵. *Centros* case involved a Danish couple incorporating a company in the United Kingdom and trying to register a branch in Denmark with the aim to render activities solely in Denmark. The Danish authorities refused registration claiming that *Centros* was formally trying to register a branch, however in substance to transfer central management of UK registered company, thus avoiding the Danish law requirements on formation of capital. In this case ECJ found that *Centros* enjoys the freedom of establishment and Denmark may not refuse registration

of a branch. Indeed the Court used very strong language, stating that entrepreneurs are entitled to choose to form a company in such Member State, the regulation of which they deem as the most flexible and this does not constitute an abuse of freedom of establishment (even where such company intends to render activities solely or mostly in another Member State)⁶. The Court further confirmed that the freedom of establishment may be restricted as all other fundamental rights, however under narrow and strict *Gebhard*⁷ criteria. This was an immigration case, in contrast to the *Daily Mail*, and ECJ concluded that the host Member State may not deprive the company of its right of freedom of establishment. However in the case itself the Court did not explain the difference between *Daily Mail* and *Centros*.

The link between the *Daily Mail* and *Centros* was analysed in another freedom of establishment case – *Überseering*⁸. The case involved Dutch company *Überseering*, which was engaged in real estate development in Germany. *Überseering* was later acquired by German nationals and eventually found to have transferred its central administration – real seat – to Germany. Thus under the German real seat theory *Überseering* was found to have lost

⁶ *Centros*, para. 25-30.

⁷ Requirements established by the Case C-55/94 *Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165: restrictions must 1) be applied in a non-discriminatory manner; 2) must be justified by imperative requirements of general interest; 3) must be suitable to attain the objectives they pursue; 4) must be proportionate.

⁸ Case C-208/00 *Überseering v Nordic Construction Company Baumagement GmbH (NCC)* [2002] ECR I-09919.

⁵ Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, [1999] ECR p. I-01459.

its legal capacity and deprived of an opportunity to protect its business interests in judicial procedure (ceasing the ability to be genuine party to legal proceedings). The parties to the dispute, unsurprisingly, pointed out to seemingly diverging position of ECJ in *Daily Mail* and *Centros*. Generalising language of the case it can be said that ECJ found the difference in the fact that *Daily Mail* was an emigration case while *Centros*, and currently *Überseering*, were both immigration cases⁹. The Court stated that only a company established under the laws of the one Member State and having a link with it may exercise the freedom of establishment, accordingly this State of origin may define what is “the link” and thus regulate the movement of company¹⁰. However the host Member State may not restrict the right of the company previously established elsewhere in the EU, to immigrate. Thus

⁹ See *Überseering*, para. 62: “unlike *Daily Mail* and *General Trust*, which concerned relations between a company and the Member State under whose laws it had been incorporated in a situation where the company wished to transfer its actual centre of administration to another Member State whilst retaining its legal personality in the State of incorporation, the present case concerns the recognition by one Member State of a company incorporated under the law of another Member State...” (underline added).

¹⁰ See *Überseering*, para. 70: “the Court confined itself to holding that the question whether a company formed in accordance with the legislation of one Member State could transfer its registered office or its actual centre of administration to another Member State without losing its legal personality under the law of the Member State of incorporation and, in certain circumstances, the rules relating to that transfer were determined by the national law in accordance with which the company had been incorporated. It concluded that a Member State was able, in the case of a company incorporated under its law, to make the company’s right to retain its legal personality under the law of that State subject to restrictions on the transfer of the company’s actual centre of administration to a foreign country.”

Germany was found to infringe the freedom of establishment of a Dutch company trying to transfer its central administration to Germany by rebutting legal capacity of the company when real seat was transferred [16, para. 82, 94]. Interestingly this case also made clear that both primary and secondary freedom of establishment are directly applicable and are enjoyed by companies as after the *Centros* it was not finally clear whether companies may enjoy only a freedom for secondary establishment (e. g. establishing a branch as in *Centros*¹¹) or both. The difference between *Centros* and *Überseering* is that in the former case the company was being formed with the view to take up activity in another Member State, while the latter cases involved the transfer of central management of already operating company. ECJ however did not apply different treatment because of this and stated that the host Member States could not hinder transfer of central administration in neither case.

Position of ECJ in *Centros* and *Überseering* was confirmed in another case *Inspire Art*¹². The case involved company *Inspire Art* which was incorporated in UK with the purpose of rendering activities mainly in the Netherlands. By that time the Netherlands, most probably reacting to *Centros* and *Überseering*, had adopted the law requiring formally foreign compa-

¹¹ Even in *Centros* it was not finally clear whether this is primary or secondary establishment. *Centros* tried to establish a branch in Denmark which looks as a secondary establishment at the same time it rendered no business in the United Kingdom and principal place of administration and business was supposed to be in Denmark.

¹² Case C-167/01 *Kamer von Koophandel en Fabrieken voor Amsterdam v Inspire Art Limited* [2003] ECR I-10155.

nies (established elsewhere but rendering activities solely or principally in the Netherlands, such as *Inspire Art*) to register branch in the Netherlands and indicate in the documents of such companies that they are registered elsewhere than the Netherlands, also meet minimum subscribed capital requirements applicable to the Dutch companies. Sanctions for failing to meet these requirements were severe including joint and several liability of the directors.

The difference from the previous case law was that the Netherlands did not deny capacity of the immigrating company entirely, however imposed additional requirements. As to the requirement to indicate information in the Dutch commercial register about a branch of a foreign company, ECJ stated that the information required to be indicated by such company is enlisted in Art. 2(1) of the Eleventh company law Directive¹³ and this list is exhaustive, with Member States not allowed to create additional requirements [17, para. 69–72]. The Court then turned to the minimum subscribed capital requirement issue. The Court restated its position in *Centros* that formation of a company in a Member State with more flexible regulation having an aim to render activities mostly or entirely in another Member State does not constitute an abuse of freedom of establishment. The Court rejected the argument that the freedom of establishment only prevents host Member State from immediate refusal to recognise the legal capacity.

¹³ Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State.

ECJ stated that the restrictions (not immediate refusal) as imposed by the Netherlands still must be checked against Art. 46 of the EC Treaty (stating that Member States may refuse to apply freedom of establishment for foreign nationals on grounds of public policy, public security or public health) and overriding reasons related to public interest (*Gebhard* criteria). The Court immediately rejected the recourse of the Netherlands to Art. 46 of the EC Treaty. Regarding *Gebhard* criteria ECJ stated that creditor protection is not a good reason to impose additional requirements as *Inspire Art* never concealed that it is a company formed under the laws of England and Wales with the capital requirements regulated by this law; in the same manner alleged protection of fairness in business dealings and efficiency of tax inspections could not satisfy *Gebhard* criteria. ECJ stated that similarly penalties imposed by the Dutch legislation such as the mentioned joint and several liability of directors was also incompatible with the freedom of establishment [17, para. 95–97, 131–140].

Accordingly from the judgments above we see that host Member States may not deny the legal capacity for immigrating companies and where they apply restrictions, these must be justified by overriding public interest. Below we will try to present this in a wider context and explain remaining rationale of *Daily Mail*.

3. Is there EC law incorporation doctrine?

The judgments of ECJ in *Centros*, *Überseering*, and *Inspire Art* have raised much of an optimism for those supporting wider

harmonisation and flexibility of company law in EU. It was stated that companies established in one Member State may transfer their central administration to another, without the host Member States being able to restrict such transfers (otherwise than by restrictions following very narrow *Gebhard* criteria). Does this create an area in EU where companies may transfer their on-going business – tangible and intangible assets together with the transfer of management – across borders (inside EU) without the need to re-incorporate, merge or undergo other formal procedure? We remember *Daily Mail*, and restrictions that Member State of origin was allowed to apply, but this was long ago – in 1988, while all further cases supported the freedom of establishment – is *Daily Mail* still the law as it stands? Some commentators indeed considered that *Centros*, *Überseering* and *Insipire Arts* were rebuttal of real seat doctrine [9, p. 499].

Accordingly, is there a *sui generis* EU incorporation doctrine, requiring that EU Member States would apply incorporation doctrine *vis-à-vis* companies established and having link with Member States? It seems that despite the *Centros*, *Überseering* and *Insipire Art*, the answer negative.

Firstly, ECJ already in *Daily Mail* case recognised that certain Member States have real seat doctrine in their private international law¹⁴ and this is not *per se* illegal. Nor this was overruled by later judg-

¹⁴ See *Daily Mail*, para. 20: “[c]ertain States require that not merely the registered office but also the real head office, that is to say the central administration of the company, should be situated on their territory, and the removal of the central administration from that territory thus presupposes the winding-up of the company with all the consequences that winding-up entails in company law and tax law”.

ments of ECJ. Interestingly in *Überseering* the Dutch government in its submissions tried to raise the issue of real seat stating: “the Treaty provisions on freedom of establishment do not preclude application of the company seat principle as such” [16, para. 44] however the Court remained silent of this particular point. Accordingly the Court has never actually considered that real seat doctrine *per se* incompatible with the freedom of establishment, although the issue was raised.

In the recent judgment of ECJ in *Cartesio*¹⁵ the Court was called to consider the emigration (and not immigration) issue, as in *Daily Mail*. *Cartesio* was a Hungarian company that transferred its real seat to Italy and applied to Hungarian company register to indicate in the register Italy as the place of its registered seat¹⁶. This makes *Cartesio* different from all the other cases defined above – it wanted some kind of very untypical structural change – transferring real seat (central administration) to Italy and then requiring that its registered seat would be registered as address in Italy, but with the Hungarian register. *Cartesio* challenged the refusal of the register to make entry in the Hungarian register, but the Court followed the reasoning in *Daily Mail*. ECJ restated that incorporation of a company is achieved through operation of the national law of the Member State of origin, accordingly it may provide requirements for the companies to be deemed incorporated under its law. The

¹⁵ Case C-210/06 *Cartesio Oktató és Szolgáltató bt.*

¹⁶ At least this is what it seems to be the situation as the wording of the case does not clearly reveal where it is referred to real seat (central administration), and where to registered seat.

Court indicated that upon emigration, the Member State of origin may require the company to retain the connecting factor (or “link” – for instance, central administration) with the Member State of origin, thus restraining the cross border movement of company’s business [21, para. 109–110].

As defined above, in order to be eligible to exercise the freedom of establishment, the company must be established with the Member State and have “link” or “connecting factor” with the Member State. The implications of *Cartesio* seem to be that upon emigration of the company the Member State of origin may require that the company be established and have another link with the same Member State (meaning Member State of origin), such as central administration. Where the company satisfies requirements of the Member State of origin, it can exercise the freedom of establishment and the host Member State may not block it (with the *Gebhard* exception as indicated above). Consequently, the current position is that a company, originating in a Member State of incorporation doctrine is entitled to transfer its central administration to another Member State (without losing legal capacity), whether the host Member State is incorporation doctrine or real seat doctrine State. A company, originating in a Member State of real seat doctrine is not entitled to transfer its central administration to another Member State (without losing legal capacity), whether the host Member State is incorporation doctrine or real seat doctrine State. The result is somewhat paradox – companies established in incorporation doctrine States can transfer central administration

to real seat countries, not having to follow, allegedly higher standards of regulation in real seat countries, while companies established in real seat countries, following, allegedly, higher company law standards, may not transfer their central administration to incorporation doctrine countries.

There are several other unanswered issues.

It is clear that a company from a Member State following incorporation doctrine can transfer its central administration to the other Member States relying on the freedom of establishment. What about a situation where a company incorporated in a Member State following real seat doctrine transfers its central administration to another Member States, however the Member State of origin ignores or does not challenge that fact. Is the host Member State or other Member States (not host and not origin) allowed to find such company to lose its legal capacity as it does not satisfy incorporation requirements of the origin Member State? The answer from *Daily Mail* and *Cartesio* seems to be no. It is for the Member State of origin to allow incorporation or not, under the conditions set by it, accordingly other Member States should not be able to exercise the rights of the origin Member State without its will. However this finding is made with reservations as ECJ has not directly discussed the matter.

Another point is that the First company law directive¹⁷ in Art. 11 provides for an

¹⁷ First Council Directive of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (68/151/EEC).

exhaustive list of nullity of companies, such as failure to comply with the national law concerning minimum amount of capital or where contrary to the national law, the number of founders is less than two. The Article states that apart from this list “a company shall not be subject to any cause of nonexistence, nullity absolute, nullity relative or declaration of nullity”. The issue is that for legal certainty there should be very limited cases where nullity of a company could be ordered. Neither of the abovementioned cases discusses the link between the First directive and the right of a Member State of origin to find that the company lost legal capacity upon transfer of its central management to another Member State. The explanation could be that the First directive refers to nullity *ab initio*, *i. e.* that the incorporation was illegal, while the loss of legal capacity takes effect only at the moment of the company transferring its central administration across the border. However this explanation is only plausible if such fining of loss of legal capacity “on the border” does not constitute what Art. 11 of the First directive calls “nonexistence” or “nullity relative”.

Further discussing EU law, it must not be forgotten that real seat doctrine is applicable to the *Societas Europaea* (SE) – a European company with its own legislative framework – as it is required that SE would have the registered office in the same Member State as its head office¹⁸. Thus SE has less opportunities to move across frontiers

than an ordinary company established in a country of incorporation doctrine.

Another issue is that from the *Daily Mail* and *Cartesio* cases it is clear that the Member State of origin is entitled to define the link with it required to provide the company incorporation, thus the Member State of origin may restrict the movement of companies across frontiers, this right being uncontrolled by ECJ. However the Court in tax cases interpreting the freedom of establishment as granted by the EC Treaty concluded that the Member States of origin are not allowed to restrict the freedom of establishment otherwise than to safeguard the overriding public interest, while complying with the *Gebhard* criteria. The two relevant cases here are *Marks & Spencer*¹⁹ and *Cadbury Schweppes*²⁰.

In *Marks & Spencer* the company challenged UK tax legislation providing that, while UK company groups were allowed to surrender losses from loss making group companies against profits of profitable group companies (thus decreasing the taxable profits of these), the UK legislation did not allow to surrender losses incurred by the group companies incorporated in the other Member States. In *Cadbury Schweppes* the company challenged UK controlled foreign company legislation, providing that where UK company establishes subsidiaries in low tax zones (which included EU Member States such as Ireland), such company was taxed on the subsidiary’s profits as well as its own

¹⁸ See Article 7 of the Council Regulation (EC) No 2157/2001 on the Statute for a European company. It is not however clear whether this is consistent with the EC Treaty requirement of freedom of establishment.

¹⁹ Case C-446/03 *Marks & Spencer v David Halsey* [2005] ECR I-10837.

²⁰ Case C-196/04 *Cadbury Schweppes plc v Commissioners of Inland Revenue* ECR [2006] I-07995.

(unless certain conditions where met or the motive for having foreign subsidiary was not to diminish UK tax).

Importantly, in *Cadbury Schweppes* the Court stated that searching for advantageous tax treatment in other Member States (than the origin Member State) does not in itself constitute abuse of the freedom of establishment [20, para. 36-038]. In both cases the Court stated that the notion of freedom of establishment is primarily directed to ensure that the host Member State does not discriminate subsidiaries or branches of companies of the other Member States. However ECJ stated that the freedom also prohibits the origin Member State from hindering establishment of its companies in other Member States [19, para. 31; 20, para. 42]. In both cases the Court found that the tax legislation actually hindered the freedom of establishment. The Court then checked whether the restrictions pursue legitimate overriding objective of public interest and comply with *Gebhard* criteria. ECJ indicated that solely reduction of tax revenue of particular Member State may not form the overriding reason of public interest. However the Court found that UK tax legislation was drafted to eliminate practices which could “significantly jeopardise a balanced allocation of the power to impose taxes between Member States” also which could amount to tax avoidance (*Marks & Spencer*) and which “specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State” – these were found to be the overriding public interest reasons. [19, para. 33–34, 44, 46; 20, para. 49, 51]

As the last point the Court verified the measures against *Gebhard* criteria. In

Marks & Spencer the Court found UK legislation to be disproportionate to the aim pursued (and thus contrary to the freedom of establishment) as the tax legislation provided for outright refusal to allow surrendering foreign group companies losses, while the aim could be achieved by requiring such foreign group companies firstly to attempt to surrender losses in the Member State of residence [19, para. 55–56, 59]. In *Cadbury Schweppes* the Court stated that the controlled foreign corporations legislation can catch only wholly artificial arrangements but it is contrary to the freedom of establishment for this legislation to catch foreign companies actually pursuing economic activity [20, para. 65–75].

There are two main conclusions about *Marks & Spencer* and *Cadbury Schweppes*. Firstly in the emigration cases (*Daily Mail* and *Cartesio*) the Court seemingly allowed uncontrolled right for the Member State of origin to restrict establishment of companies in other Member States while in the tax cases the Court already controlled the restrictions applied by the Member States of origin, requiring overriding reason of public interest and compliance with the *Gebhard* criteria. What is the difference between these two types of cases? It seems that in the emigration cases the issue was not that of freedom of establishment, but whether the company was incorporated or not and it was the right of the origin Member State to grant or not to grant incorporation (the rationale being that first you need to have a company and then you can exercise the right of freedom of establishment and the origin Member State will tell you if you have the company or not); while in the tax cases the Court considered the genuine

freedom of establishment issue as the existence of companies was not questioned. However this explanation is not obvious. The second conclusion is that after *Inspire Art* it was very unclear what actually could form an overriding public interest reason to justify restrictions of the freedom of establishment. After *Marks & Spencer* and *Cadbury Schweppes* it seems that “a balanced allocation of the power to impose taxes between Member States” and prevention of “wholly artificial arrangements aimed at circumventing the application of the legislation” may form this public interest reason even for host Member States.

Accordingly we see that there are many uncertainties surrounding the transfer of central administration to another Member State. Particularly controversial is the consequence that companies registered in real seat doctrine States cannot transfer their central administration to other Member States while those registered in incorporation doctrine States can. Below we discuss alternatives for cross-border business restructurings.

4. Impact of absence of EC incorporation doctrine

We can see that there is a room for real seat doctrine in the EU. The Member States following real seat doctrine may not prevent the companies from immigrating to them, but may prevent (consider as without legal capacity) their own companies from emigrating abroad.

Does it make a huge difference? We will try to apply teleological reasoning here.

Transfer of central administration is one of the forms of the cross-border re-

structurings that the company may want to undertake. The purpose and effect of such restructurings may be threefold: 1) change of the applicable law to the company; 2) transfer to more favourable market conditions and business regulation; 3) growth of the company [9, p. 490–491].

The companies incorporated in real seat countries are deprived of an opportunity to undertake restructurings having effects in (2) and (3) without necessarily having effect of (1). While the companies established in incorporation doctrine countries may implement growth and transfer business to a country with more favourable market conditions, without changing the law applicable to the company and thus make use of wide opportunities of regulatory arbitrage. Still the former companies enjoy other cross-border restructuring opportunities, having all 3 abovementioned effects:

- they can establish *Societas Europaea*, enabling the companies to implement cross-border merger, upon formation of SE, and to transfer registered office together with the real seat to the other Member States, without the need to re-incorporate [6, Art. 8,17];
- they can implement cross-border merger of two or several public companies, or two or several private companies; it may be done solely for the purpose to transfer registered office to another Member State²¹;
- the most interesting case – it occurs from *Cartesio* and earlier *SEVIC Sys-*

²¹ Under national measures implementing Directive 2005/56/EC on cross-border mergers of limited liability companies.

*tems*²² cases that the freedom of establishment requires Member States to allow companies to transfer their registered office to another Member States, without the need to re-incorporate, this being applicable to both directions: emigration and immigration²³. It seems that where a company wants to transfer its registered office to a real seat doctrine country, the central administration will also have to be transferred to the same direction, but when the company transfers registered office to incorporation doctrine country it can transfer the registered office without central administration. This however does not mean expansion of incorporation doctrine since such company becomes “national” of the other Member State.

²² Case C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

²³ Which is essential difference from the cases of exercising freedom of establishment by transferring central administration without transferring registered seat. The *SEVIC Systems* case involved a Luxembourg company being merged into (merger by takeover) a German company, and the German register refused to register such a merger for the only reason that it was cross-border (the Cross-border mergers directive did not apply at that time). ECJ stated that the company thus exercises freedom of establishment and may not be restricted from doing so. *SEVIC Systems* was novel in such manner that it involved transfer of real seat and transfer of registered seat together. ECJ stated that the freedom of establishment still applies. *Cartesio* case seems to have expanded this interpretation in two important directions: 1) the freedom of establishment is applicable not only to cross-border mergers but also to single company cross-border transfers of registered office; 2) that the freedom of establishment enables to transfer registered office in both directions: immigration and emigration (without Member States being able to block such movements by other means than those complying with *Gebhard* criteria). Interestingly the European Commission abandoned its plan to prepare 14th Company Law Directive on the transfer of the registered office (to another Member State), however it seems that ECJ in *Cartesio* adopted its own very short 14th Directive.

Accordingly even companies established in real seat doctrine Member States can implement cross-border restructurings, these being more complex, formalised and costly than simply transferring the central administration to another country, but still probable. Of particular interest seems the third option, however without further regulation it is not fully clear under what conditions it will be allowed to take place.

At the same time there are uncertainties left. Firstly, companies registered in incorporation doctrine states and moving their central administration to other Member States will face uncertainties regarding their “internal law” applicable. For instance the shareholder rights, board election, managerial decisions and articles of association will be regulated by the Member State of origin, however there is some “grey” zone where it is not clear to what extent the law of the host Member State will be applicable. For instance the host Member State law should be applicable for fraudulent insolvency matters. Less clear situation is with the employee participation in management of companies. Current position seems to be that this is corporate governance matter and should fall under “internal law”, thus being regulated by the law of the Member State of origin however the answer is not finally clear. Another point is that inevitably companies rendering business will face litigation in the host Member States and courts of these countries will have to apply the law of origin Member State to such matters as due authorisation to act on behalf of the company or necessary corporate approvals for business contracts. And *vice versa* where

for instance shareholders will file an action challenging decision of the board of the company, the court of the origin Member State will have to assess the activities of the company in host Member State.

The problem with transfer of registered office across border as allowed by *Cartesio* is that Member States do not have legislation ready to make the procedure clear. Obviously there is a need to protect creditors in such situation at least by requiring company to announce publicly of its transfer of registered office. Even more sensitive issue is taxation in the event of transfer of registered office as in many cases the Member State of former registration will lose its jurisdiction to tax company's income on global basis (and will be able to tax only on source bases) thus losing tax revenue. On the other hand unpredictable tax consequences deter companies from taking up this transfer of registered office.

Conclusions

There is no harmonized document telling what private international law regime should Member States apply to legal persons. Currently Member States apply both incorporation and real seat doctrines, both found legal by ECJ. The EC Treaty guarantees the fundamental freedom of establishment for companies: freedom to form a principal place of business or set-up agencies, branches or subsidiaries in another Member State. The freedom of establishment notion has been widely interpreted during last decades by ECJ. The position of Court could be structured in the following conclusions:

1. companies may enjoy the freedom of establishment if they are duly established in a Member State and have a link with a Member State (registered office, central administration, or principal place of business);
2. it is up to the Member State of registration to define the link required with the company to grant incorporation in that Member State and this discretion seems not to be restricted;
3. the host Member States are not, however, allowed not to recognise the companies transferring their central administration to these States. If such host Member States want to restrict the freedom of establishment of immigrating companies, they must show the overriding public interest reason, which has proved to be difficult;
4. most likely protection of balance within the Community of Member States jurisdiction to tax income of companies and prevention of artificial arrangements created for tax avoidance would form the overriding public interest reason and the Member States here can apply restrictions to freedom of establishment. Still such restrictions need to comply with the *Gebhard* criteria.

The paradox of the current case law is that the companies established in incorporation doctrine States may transfer their central administration to another Member States, while those incorporated in real seat doctrine States may not.

This somewhat discriminatory practice has only limited impact. The companies still have opportunities to restructure their businesses across border by engaging in

cross-border merger, formation of *Societas Europaea* or transferring their registered seat to another Member State.

The rising number of companies established in one Member State but having their central administration in another

causes certain problems. The most obvious is allocation of the law applicable in such matters as creditor protection and employee participation in management of a company; also rising need to apply foreign law by courts.

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STEIGIMOSI LAISVĖ PO *CARTESIO* BYLOS: ES INKORPORAVIMO DOKTRINOS TRŪKUMAS IR TO PADARINIAI

Robertas Čiočys

S a n t r a u k a

Tarptautinėje privatinėje teisėje juridinių asmenų civilinis teisnumas nustatomas remiantis inkorporavimo arba buveinės principais. Remiantis inkorporavimo principu, juridinio asmens teisnumas nustatomas pagal valstybės, kurioje tas juridinis asmuo registruotas, teisę. Vadovaujantis buveinės principu juridinio asmens teisnumas nustatomas pagal valstybės, kurioje yra juridinio asmens centrinė administracija (buveinė, valdymo organo buvimo vieta), teisę.

Europos Sąjungos mastu nėra nustatyta, kuri principą valstybės narės turi taikyti. Byloje *Daily Mail* Europos Teisingumo Teismas pripažino, kad valstybės narės gali taikyti tiek inkorporavimo, tiek buveinės principus. Tačiau vėlesnėse bylose, kuriose teismas nagrinėjo EB steigimo sutarties garantuojamą įsisteigimo laisvę, *Centros*, *Überseering* ir *Inspire Art*, teismas apribojo buveinės principo taikymą. Šiose bylose buvo nagrinėjamos situacijos, kai bendrovės perkėlė centrinę administraciją („imigravo“) į kitą valstybę narę (priimančią valstybę narę), tačiau liko registruotos pirmesnėje valstybėje narėje (registracijos valstybėje narėje). Teismas pažymėjo, kad priimanči valstybė narė negali laikyti, jog „imigruojanti“ bendrovė praranda civilinį teisnumą. Jeigu valstybė narė nori taikyti ribojimus „imigruojančiai“ bendrovei, tokie ribojimai turi būti pateisinami svarbesniu viešuoju interesu, o patys ribojimai atitikti *Gebhard* byloje suformuotus kriterijus (ribojimai turi būti nediskriminuojantys, pateisinami viešuoju interesu, tinkami siekiamam tikslui pasiekti, proporcingi). Svarbesnis viešasis interesas yra interpretuojamas siauriai, tikėtina, kad pateisinamos priežastys taikyti įsisteigimo teisės ribojimus galėtų būti siekis išsaugoti suderintą valstybių narių jurisdikciją apmo-

kestinti bendroves, taip pat neleisti visiškai dirbtinių schemų, skirtų vengti mokesčių mokėjimo.

Byloje *Cartesio* teismas patvirtino poziciją ankstesniame *Daily Mail* sprendime ir nurodė, kad registracijos valstybė narė suteikia bendrovei juridinio asmens statusą ir ši valstybė turi teisę nurodyti, koks ryšys turi sieti bendrovę ir valstybę. Taigi registracijos valstybė narė turi teisę riboti bendrovės centrinės buveinės perkėlimą į kitą valstybę narę. Dėl tokios teismo pozicijos susidaro paradoksali situacija, kai inkorporavimo principą taikančių valstybių narių bendrovės gali perkelti centrinę administraciją į kitas valstybes nares (ir priimančios valstybės narės praktiškai to negali riboti), o buveinės principą taikančiose valstybėse narėse įsteigtos bendrovės to daryti negali (nes registracijos valstybė narė, taikydama buveinės principą, konstatuos, kad bendrovė prarado civilinį teisnumą).

Kita vertus, net ir buveinės principą taikančiose valstybėse narėse įsteigtos bendrovės gali pasinaudoti kitomis priemonėmis, siekdamos pertvarkyti verslą, pavyzdžiui, steigti Europos bendrovę, sujungiant reorganizuoti bendroves, esančias skirtingose valstybėse narėse ir, tikėtina, remiantis teismo pozicija *Cartesio* byloje, perkelti į kitą valstybę narę registruotą buveinę.

Didėjanti bendrovių migracija ir kelias valstybes nares apimanti verslo pertvarka sukelia ir problemų. Neaiškūs tokių pertvarkymų mokesčiai padariniai, tam tikrais atvejais sunku nustatyti taikytiną teisę, pavyzdžiui, kyla klausimas, ar priimanči valstybė narė turi teisę taikyti taisykles, reglamentuojančias kreditorių apsaugą (nuo nesąžiningo bankroto) arba darbuotojų teisę būti atstovaujamiems bendrovės valdyboje.

Įteikta 2009 m. lapkričio 20 d.

Priimta publikuoti 2010 m. balandžio 7 d.